DOW THEORY LETTERS INC.

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THE MARKET: A subscriber writes: "I note that you have been talking more and more in terms of orthodox Dow Theory while other analysts have been increasingly engrossed in the many technical indicators. This is fine with me. History points to many instances when the Averages have told the true story while the rest of Wall Street was looking the other way. Please continue to stress the most reliable 'indicators' of all — the Averages." (L. R., Palm Beach, Florida).

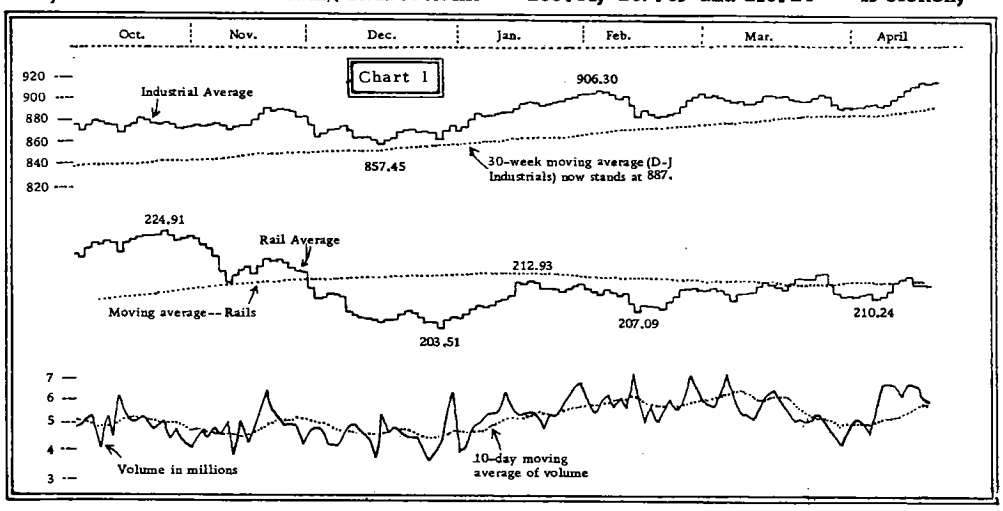
These Letters offer one of the most comprehensive charts of the various market indicators available. I feel that the 23 indicators shown on Page 1 are all significant, and I believe that knowledgeable market students should be aware of what these 23 indicators are saying and doing. Nevertheless, I have stated on many previous occasions and I repeat now that in my opinion the most important market conclusions can be drawn from the action of the Averages themselves. This is in line with classic Dow Theory as set forth by Dow, Hamilton and Rhea.

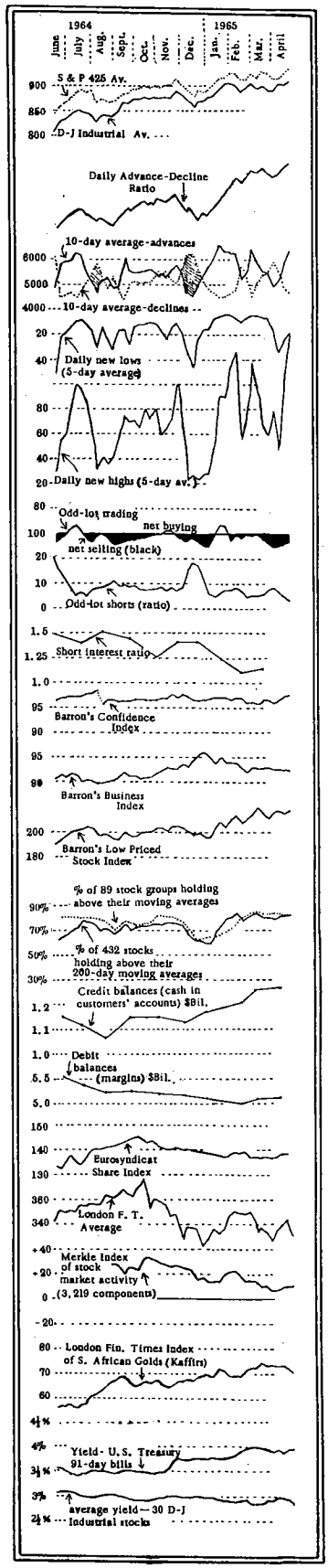
* * * *

I have been studying the price structure (Industrials and Rails) with unusual care over the past week. Two factors are evident: (1) the "relentless" character of the Industrial advance. The long, slow, upward pressure has resulted in 34 months of upward zig-zags for the senior Average. The only two movements in market history which can be compared with this in duration are the 40 month rise of 1926-29 and the 31 month advance which carried from 1953 to April, 1956. Long, persistent advances of this type often set the public to believing that the market "can never go down." Accordingly, such movements often terminate amid rampant speculation. (2) The second interesting facet of the advance is the recent reticence of the Rails. For six months (since October) the carrier Average has steadfastly refused to confirm the Industrial advance. There have been many instances in the past in which Rails provided belated (but valid) confirmations. Nevertheless, from the long-term standpoint the failure of Rails to confirm is a factor well worth watching.

For the intermediate term, note that on April 12 the Industrial Average hurdled its February high, thereby rising to the highest points in stock market history. Surprisingly, Rails refused to confirm in even a minor way by bettering their March peak of 215.98 (and this despite "war news" — which is almost always favorable to the carriers).

All in all, I strongly suspect that the clue to the strength or weakness of the market now resides with the Rail Average. It is well to remember that the Rails recorded an historic high of 224.91 in October, 1964. A low of 203.51 was established by Rails in December. Note (Chart 1) that since the December low, two higher bottoms were set — one in February at 207.09; one in April at 210.24. In my opinion, as long as the progression of higher Rail bottoms remains intact, the Industrial Average will have enough confirmatory strength to continue pushing out. But if the continuity of the series of ascending Rail bottoms — 203.51, 207.09 and 210.24 — is broken,





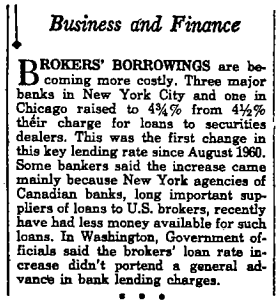
then I believe the market could run into trouble. Put another way, I would guess that if Rails broke below 210.24 we would then have divergence enough to proclaim that the first "danger flag" was flying.

In the meantime, as stated many times, as long as one or both Averages hold above the December (secondary) lows of 857.45 and 203.51, Dow's Theory is saying that the primary trend remains bullish

The Composite Chart shows the two leading averages and the A-D ratio at their highs. The A-D ratio between March 30 and April 20 rose for 15 consecutive days which is something like a record. A sharp correction followed by a "selling climax" would not be unexpected following this period of "buying compression." New highs have hit their best level in over a year and all in the face of steady odd-lot selling — again a positive performance. Although Barron's Business Index is sluggish, its Confidence Index has bounced back within a fraction of last November's high of 97.6. Foreign markets as seen by the Eurosyndicat Index and the London Index continue sloppy. The spread between the yield on the 91-day Treasury bills and the yield on the Industrial Average has widened over the past few weeks and is now at an extraordinarily unhealthy stage. Conclusion: Long-term danger signals but no real technical deterioration yet.

SUNDRY DATA: Subscribers will note that I am including more "news" in these Letters than ever before. The reason is obvious. Critical (trend-setting) events are now developing so fast that I fear many of them may escape any but the most industrious investors. Yet these events should be known and understood by all subscribers.

(1) Despite all the promises and predictions to the contrary, the pressure on interest rates continues up. One reason for this is the frightening exit of U. S. gold in 1965. As the accompanying montage of advertisements from the New York Times shows, the battle for money at the retail level continues to be fierce. From the pace-setting end of the money market (i.e., the California savings & loans institutions) comes the latest word — 5% for savings. A second area of tightening money is brokers' loans. We read about this new development in the April 16 Wall Street Journal (see clip). Finally, for 59 months the Federal Reserve Board has been printing money, thereby providing banks with net excess reserves. Over the past seven weeks this too has changed. Bank reserves have now shifted to net borrowing, which means pressure on the banks as far as new loans are concerned. Thus, while President Johnson talks easy money, the Fed acts to make money tighter.



Business and Finance

BROKERS' BORROWINGS are becoming more costly. Three major banks in New York City and one in Chicago raised to 4¾% from 4½% their charge for loans to securities dealers. This was the first change in this key lending rate since August 1960. Some bankers said the increase came mainly because New York agencies of Canadian banks, long important suppliers of loans to U.S. brokers, recently have had less money available for such loans. In Washington, Government officials said the brokers' loan rate increase didn't portend a general advance in bank lending charges.

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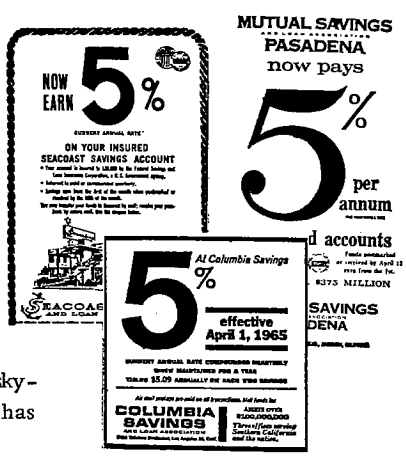
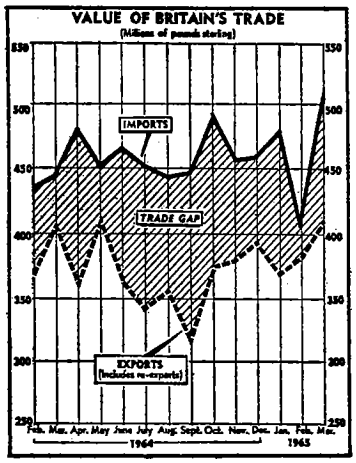


(2) The accompanying chart of the British trade balance for March is not a happy picture. Imports skyrocketed in March, in some part due to the ending of the U. S. dock strike. But remember, Britain has promised to reduce its 15% import tariff, and if this occurs, it should stimulate even higher imports. Meanwhile, Britain's new budget does little or nothing to make Britain more competitive (competitiveness is the crux of the problem), and Britain's exports remain sluggish. Result: a balance-of-payments deficit of $190 million for March vs. $101 million in February. Hardly a comforting set of statistics when we realize that the early part of the year is favorable (seasonally) for British balance-of-payments. On all this rests the future of the pound.



(3) I have been asked about my reaction to the President's Viet Nam speech. In my opinion, the offer of $1 billion in aid was a ghastly mistake. It was a vulgar proposition, and it reminded me of the man who is trying to teach a dog a new trick while he holds a bone in one hand and a whip in the other. The Vietcong has been placed in the position of the dog. They must feel that they will "lose face" if they accept money instead of napalm and bullets (although I doubt if they are ready to accept the bone anyway). The whole Johnson offer opens up the charge of "dollar diplomacy," and this nation cannot seem to learn that when you shove a fistfull of greenbacks in a man's face, you may arouse his greed— or his intense hatred.

(4) I believe the Chinese are now calculating whether the U. S. (in the light of world opinion) would use nuclear bombs on teeming Chinese cities — in the event of the mass entrance of Chinese troops into Viet Nam. I have little doubt that the Chinese would be willing to fight the U. S. on conventional (non-nuclear) terms, even with obvious U. S. control of the air. It is the question of a nuclear war which is giving them pause. In announcing a possible mobilization of "volunteers," the Chinese are feeling us out while putting the pressure on. Meanwhile, the reaction of the market (like the reaction of the American people) is that "we have gone through this before." It is all so "pat" that it bothers me considerably.

GOLD: On the week ending April 15 the U. S. announced the loss of another $150 million of gold, thereby bringing the total 1965 gold loss to just short of $1 billion. On the same day, Jacques Rueff, the famous French economist (speaking in New York) called for a doubling of the price of gold and a return to the full gold standard as the only hope for ending the gathering monetary mess.

Between 1931 and 1961 this brilliant economist (he is the only economist ever to be elected to the exclusive 330-year old French Academy) delivered a series of lectures in which he argued the extreme necessity of a world return to the full gold standard instead of the current gold exchange standard. (The gold exchange standard allows nations to count reserve currencies — pounds and dollars — as part of their reserves exactly as if these pounds and dollars were actual gold. Under the gold exchange system the same amount of gold is counted twice, once in the reserves of the U. S. or Britain and once in the reserves of the foreign nation which holds the dollars and pounds. It was this system, believes Rueff, which accounted for the severity of 1929-32. Rueff states this premise as follows: "The

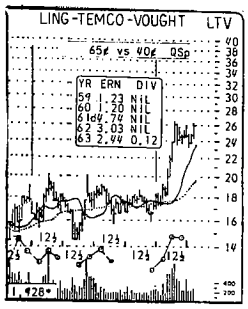
seriousness of the Depression was due entirely to this duplication process. The swollen stream of capital that flowed back to Europe was accompanied by an actual duplication of credit facilities all over the world — by a very large increase in the volume of potential purchasing power. These conditions generated the unprecedented prosperity of the 1928-29 boom." And subscribers should remember that this is the same gold exchange standard which we are using today.

Rueff is the single most important critic of the present world monetary system. Rueff's thinking is the single most important block to the existing Anglo-American policy of massive inflation. For these reasons, I urge all my subscribers to expose themselves to Rueff's thinking.

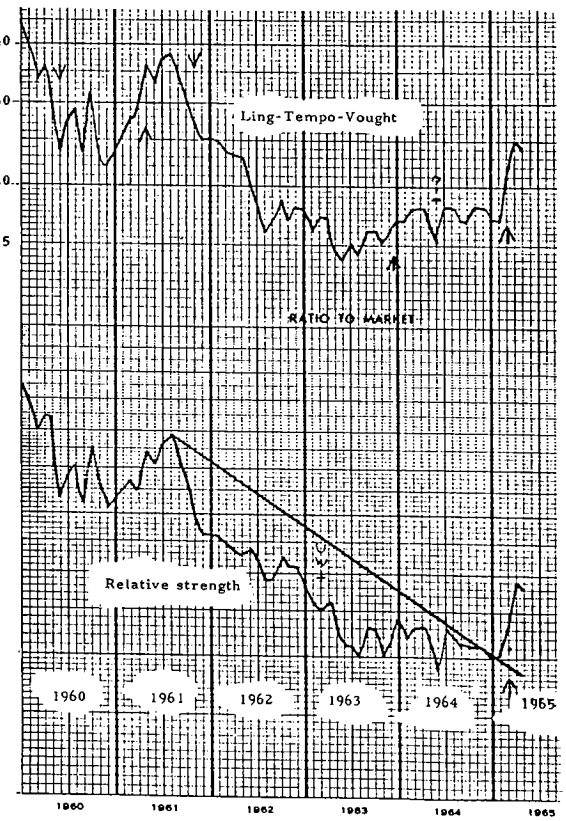
The backbone of the Rueff viewpoint is contained in a collection of his lectures. The collection is entitled The Age of Inflation published by Henry Regnery Co., of Chicago in paperback ($1.45). This book is must reading for all who wish to understand the current world monetary situation. The book is written clearly, simply, and is filled with ideas and common sense. Make no mistake about it, Rueff is firm in his conviction that the current gold exchange standard is building a "house of cards" which could be paving the way for another 1929. "To persist in the present course," warns Rueff, "is to court catastrophe. I am convinced that under present circumstances our first duty is to try to put some sense into the thoroughly muddled thinking of the men of today. I am convinced that if we do not succeed in this, our civilization must end."

STOCKS: My friends at Indicator Digest (Palisades Park, N.J.) seem to miss nothing, and their latest report notes that Day Mines (recommended in the last Letter) purchased about a quarter of a million dollars worth of Western Holdings, Free State Geduld and Western Deep Levels B in the last quarter of 1964. I continue to like all three of these — as well as Day Mines itself (which is acting quite well).

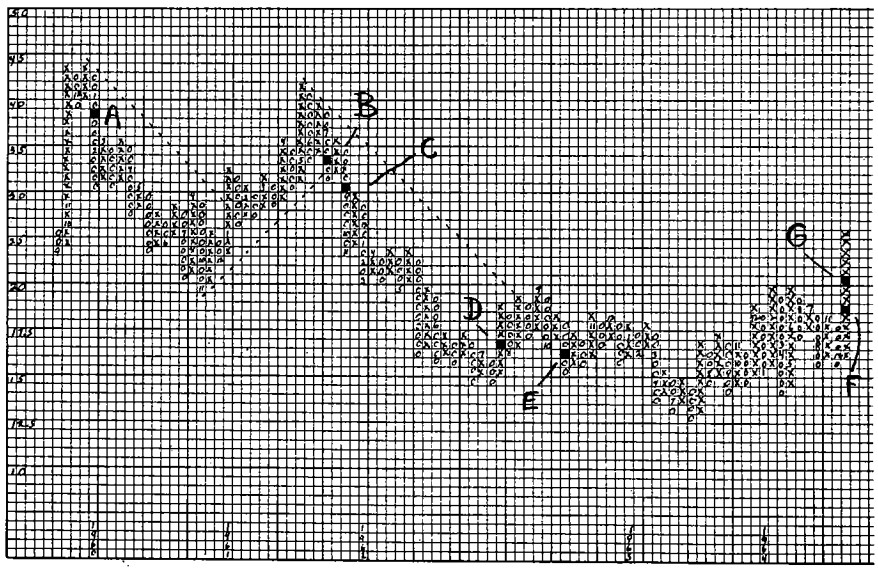
Baldwin-Lima, recommended in Letter 282 and again in Letter 284, is acting beautifully and is rising to new highs almost daily now. Continue to hold it, but it is probably too late to make initial commitments.



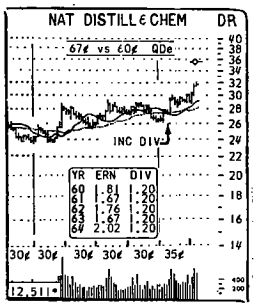
One advantage of living in San Diego is that it is easy to get military news here (this is Pacific Fleet Headquarters). The word I receive is that the light attack bombers which are so successful in Viet Nam (although now largely produced by Douglas) may soon come from Ling-Tempo-Vought (I am told the LTV plane is better). At any rate, as seen on the monthly chart, LTV has reversed a five-year downtrend in market "popularity" or relative strength (R.S.). This stock (see small weekly chart) has moved up sharply over the last few months, its earnings have improved, and it should be a "buy" on any dip to or near its 10-week moving average of 24. I have also included one of the wonderful charts from Chartcraft's Long Term Point & Figure Chartbook. P & F charts are perfect for getting a "feel" for the big picture. These charts show only price change (time means nothing on P & F charts although it is marked at the bottom of the chart), and thus the action alone makes the pattern. The X's on the chart denote rallies and the O's signify declines. Only rallies or declines of 3 points or more are shown; thus these particular P & F charts are known as 3-point reversal charts.

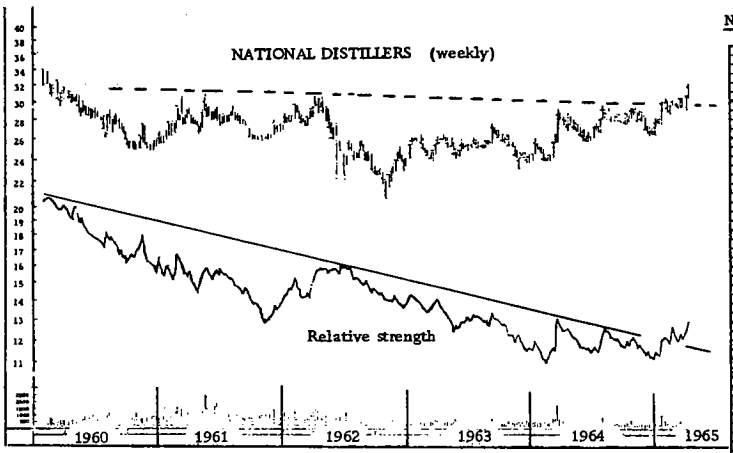


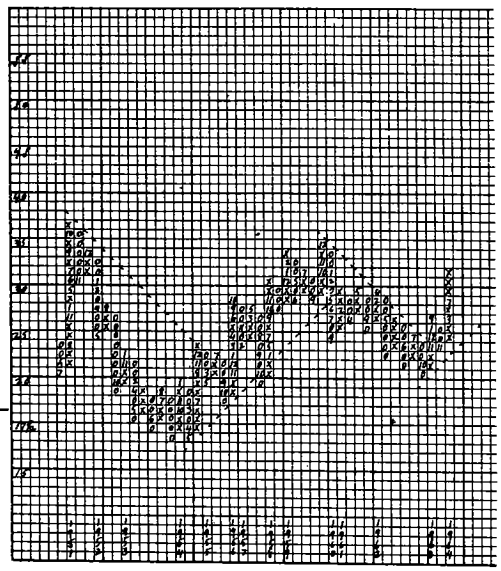
LING-TEMCO-VOUGHT (LTV)



The peak for LTV was touched in 1960 at 44. A sell signal was given at 39 (A on chart) when the little "box" in the 44-40 range broke down. The stock fell to 20. A new uptrend during 1961 took LTV to 42 and another sell signal was given at 34 (B). At C a second stronger sell signal was provided. LTV sank to 15. At D a first buy signal was given. The stock rose to 20 again, reversing the long downward trendline. At E the stock broke down and a final low was recorded at 13. Over the most recent period a new buy signal was given at 18 (F), and a second very important buy signal was given at 21 (G). Note that the whole structure from 1962 to the present has taken the form of a giant "head-and-shoulders bottom." This structure is huge, providing an intermediate "count" of 31 and a long-term



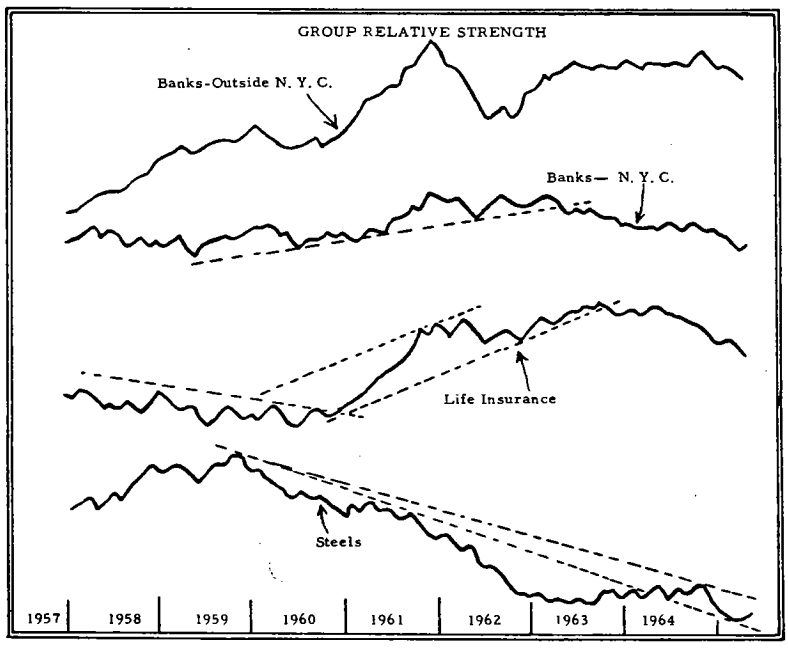




count in the 50's. It is one of the largest bases on the N.Y.S.E., and I believe LTV is an interesting buy on any dip. There should be very strong support at 20.

Back in Letter 269 I recommended Schenley at 23. It subsequently rose to above 34. The Distiller group is still very strong, about sixth on the Standard & Poor listing of 88 stock groups. So here comes another distiller — National Distillers & Chemical Corp. My long-term chart shows the relative strength on DR to be at approximately a 15 year low! As seen on the weekly bar chart, however, DR's relative strength is now in the process of what could be an extremely important reversal. Furthermore, the same chart shows what appears to be another huge head-and-shoulder bottom. Turning to the P & F chart we see that the high for DR over the past 15 years (1951) was 37. The current base on DR is large enough to provide a current rise to around 39. But if DR can better its 1960 peak of 35, I think something important could be in the wind. It may be that our modern world is driving us all to drink and the distillers to higher prices, but earnings are pushing up for DR and it is an attractive commitment. I would prefer buying it on a dip to around 30 if possible.

The accompanying Group Relative Strength chart covers four groups about which I have received more questions than any others over the past month. Many subscribers own one or more bank or insurance stocks. It is difficult to obtain information on these groups (most of these issues are over-the-counter), but they constitute a very large and important segment of the market. As seen on the chart, banks outside N.Y.C. about kept up with the general market during 1963 and 1964. During mid-1964 to the present, out-of-town banks performed worse than the market. The N.Y.C. banks have put on a poorer performance, and here relative strength has been dropping since 1962. I consider both of these groups unattractive. I believe their peak strength, which occurred in 1961, will not be surpassed during the remainder of this bull market.



The widely-touted life insurance companies saw their peak of popularity in 1963, and relative strength in this group has broken down badly since then (the chart shows that R.S. for insurance stocks has now declined to its lowest level since 1961). The market appears to be wary of the life stocks, and I suggest that subscribers heed the "advice" of the market.

Finally, the steel stocks have been in a popularity decline since 1959. A seven year drop in R. S. is extraordinary, and it suggests that this group may now be more resistant than most to a general market decline (steels should be nearing a "sold-out" state). Note that in 1964 the steel group appeared to be turning up in R. S., and thus the lower trendline was drawn on the chart. But this year the group sank to a fresh new low in R. S., and I therefore drew in the second (higher) trendline. This is not uncommon action in R. S. (although it can be frustrating for steel stock holders). My bet is that as and when the steel group pushes above the higher R. S. trendline, that will mark the real turnaround. In the meantime, the downside risk in steels after a seven-year decline in R. S. should be considerably less than most other groups in the market.

Weekly bar-line chart of National Distillers courtesy of Traders Research , 1431 Pearl St., Alton, Illinois. Small weekly charts courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas. All P & F charts courtesy of Chartcraft, One West Avenue, Larchmont, New York 10538.